INDEX

	Page
Opinion below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	3
Summary of argument	6
Argument:	
I. Partnership profits received as such constitute taxable income	7
II. The amount of partnership profits taxable as income is not limited to the excess over the amount included in the estate in computing the estate tax	15
Conclusion	20
Appendix	21

CITATIONS

Cases:	
Bull v. *Commissioner*, 7 B. T. A. 993	6
Burnet v. *Logan*, 283 U. S. 404	12, 18
Burwell v. *Mandeville's Executor*, 2 How. 560	11
Burnet v. *Whitehouse*, 283 U. S. 148	18
Helvering v. *Butterworth*, 290 U. S. 365	11
Hill v. *Commissioner*, 38 F. (2d) 165, certiorari denied, 281 U. S. 761	13
Irwin v. *Gavit*, 268 U. S. 161	16, 17, 18
Ithaca Trust Co. v. *United States*, 279 U. S. 151	14
Nichols v. *United States*, 64 C. Cls., 241, certiorari denied, 277 U. S. 584	16
Pope v. *Commissioner*, 39 F. (2d) 420	13
United States v. *Carter*, 19 F. (2d) 121	14
United States v. *Supplee-Biddle Co.*, 265 U. S. 189	16
United States v. *Wood*, 8 Fed. Supp. 939	12
Waud v. *United States*, 71 C. Cls. 567	16, 17
Statutes:	
Revenue Act of 1918, c. 18, 40 Stat. 1057:	
Sec. 213	21
Sec. 218	21
Sec. 219	22
Miscellaneous:	
G. C. M. 7616, IX–1 Cumulative Bulletin 219	8

In the Supreme Court of the United States

OCTOBER TERM, 1934

No. 649

ERNEST M. BULL, SOLE SURVIVING EXECUTOR AND Trustee of the Estate of Archibald H. Bull, Deceased, petitioner

v.

THE UNITED STATES

ON A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

OPINION BELOW

The opinion of the Court of Claims (R. 87–89) is reported in 6 F. Supp. 141.

JURISDICTION

The judgment of the court below was entered March 5, 1934 (R. 89). A motion for a new trial was overruled October 15, 1934 (R. 90). The petion for a writ of certiorari was filed January 15, 1935 (R. 90), and was granted March 4, 1935. The

jurisdiction of this Court rests on Section 3 (b) of the Act of February 13, 1925.

QUESTION PRESENTED

The decedent was a member of a partnership. By the partnership agreement his estate was given the option of sharing in the profits and losses of the business for a year after his death, or of withdrawing. The question presented is whether a share in the profits earned by the business subsequent to the decedent's death and paid to his estate constitutes taxable income to the estate.

STATUTES INVOLVED

The applicable statutes are set forth in the Appendix, *infra*, pp. 21–22.

STATEMENT

The findings of fact of the Court of Claims (R. 83–86) may be summarized as follows:

The petitioner is the duly qualified and acting sole surviving executor and trustee of the estate of Archibald H. Bull, a citizen and resident of New Jersey, who died testate on February 13, 1920 (R. 83).

Until his death the decedent was a member of the partnership of A. H. Bull & Company, ship agents and brokers (R. 84). The partnership was created by written agreement of January 9, 1918, providing that the partnership was to begin January 1, 1918, and continue for one year from that date

(R. 84). After December 31, 1918, the partnership continued to operate from year to year by mutual consent of the partners without any further agreements (R. 84). The partnership agreement provided (R. 84):

> that in the event of the death of any one of the said copartners, the surviving partner or partners shall be at liberty to continue said business, and the estate of the deceased partner shall receive the same interests, or participate in the losses to the same extent, as said deceased partner would, if living, based on the usual method of ascertaining what the said profits or losses would be for one year subsequent to the death of the said partner or partners. Or the estate of the deceased partner shall have the option of withdrawing his interest from the firm within thirty days after the probate of will or letters of administration, and all adjustments of profits or losses shall be made as the date of such withdrawal.

The first method set out in the partnership agreement was followed by the surviving partners and the estate up to December 31, 1920 (R. 84). The intent and meaning of the agreement were that the surviving partner or partners and the estate of the deceased partner might permit the interest of the decedent to remain in the business to the end of the calendar year in which he died (R. 84).

The partnership was engaged in the ship brokerage business, for which no capital was required and

none was ever invested by the partners (R. 84). At the decedent's death, February 13, 1920, his share of the partnership profits in connection with business transacted from January 1, 1920, to his death, amounted to $24,124.20 (R. 84). The decedent had no other accumulated profits in the business and owned no other tangible property in connection therewith (R. 84). Thereafter the decedent's estate received $212,718.79 from the surviving partners, that amount being the portion of the profits of the business carried on by them from February 13 to December 31, 1920, which the decedent would have been entitled to receive for that period if he had lived (R. 84–85). Of the amount last named, $200,117.09 was received during the period mentioned, and $12,601.70 was received during the first two months of 1921 (R. 85). The decedent's estate received no further sums from the operation of the business subsequent to February 13, 1920, and all interest of the estate in the earnings and property of the business terminated at December 31, 1920 (R. 85).

In filing an estate-tax return, the decedent's executor included the decedent's interest in the partnership at a value of $24,124.20, which represented the decedent's share of the earnings accrued to the date of the decedent's death (R. 85). The Commissioner valued such interest at $235,202.99, arrived at by increasing the value by $212,718.79, the total thus representing the full amount received by the estate from the surviving partners (R. 85).

The estate tax on this increased amount was $41,517.45 (R. 85).

On April 14, 1921, the petitioner filed an income-tax return for the estate for the period from February 13, 1920, to December 31, 1920, which did not include the amount of $200,117.09 received during the period for which the return was filed as the share of the profits earned by the partnership (R. 85). The estate employed the cash receipts and disbursements method of accounting (R. 85).

In July 1925, the Commissioner determined that the sum of $200,117.09 received in 1920 should have been returned by the executor as income to the estate for the period February 13 to December 31, 1920, and notified the petitioner of a deficiency in income tax due from the estate for that period, in the amount of $26 ,212.65, which was due, in part, to the inclusion of that amount ($200,117.09) as taxable income, and, in part, to adjustments not in controversy here (R. 85). No deductions was allowed by the Commissioner from the amount of $200,117.09 on account of the value of the decedent's interest in the partnership at his death (R. 85).

On September 5, 1925, the petitioner appealed to the United States Board of Tax Appeals from the deficiency asserted by the Commissioner (R. 85). The Board affirmed the action of the Commissioner in including the item of $200,117.09 in taxable income without any deduction on account of the value of the decedent's interest in the part-

nership at his death, and determined a deficiency of $55,166.49. *Bull* v. *Commissioner*, 7 B. T. A. 993 (R. 85–86). The deficiency was paid with interest of $7,510.95 on April 14, 1928 (R. 86).

On July 11, 1928, the petitioner filed a claim for refund of $62,677.44 on the ground that the item of $200,117.09 was corpus and had been erroneously included as income to the estate (R. 86). The claim was rejected May 18, 1929 (R. 86).

The court below dismissed the petition (R. 89).

SUMMARY OF ARGUMENT

The challenged tax is imposed upon partnership profits distributed to the estate of a deceased partner. Such profits are clearly income in the ordinary case, but petitioner contends that since the estate had the right to receive them, and such right was valued as a part of the decedent's gross estate for estate tax purposes, the receipts may not be taxed unless in excess of that value.

Upon analysis, it appears that the right of the estate to receive these profits was a proprietary right, which came into existence when the estate elected to have the business continued without the withdrawal of the decedent's interest. Hence, the right of the estate was not different in character from the right of the decedent, while he was living.

Petitioner contends that only the excess of profits over the value of the decedent's interest in the business at the time of his death may be treated as taxable income. Even if that be true, the amount

which the Commissioner has treated as income ($200,117.09) does represent only the excess of profits over what the Court has found to be the value of the decedent's interest in the business at the time of his death ($24,124.20). The rule for which petitioner contends has accordingly been satisfied.

We submit, however, that there is no requirement of the statute or regulations that limits the taxable income to the excess over the value of the decedent's interest at death. The right to future profits is a right to receive income, and there is authority in the decided cases for taxing income, properly so-called, even though the principal which produced it be a bequest, and also despite the fact that the transfer of the right to receive it had been taxed as part of the estate.

ARGUMENT

I

PARTNERSHIP PROFITS RECEIVED AS SUCH CONSTITUTE TAXABLE INCOME

What has here been taxed is a share in the profits of a partnership or joint venture. We submit that the estate had a proprietary interest in the business, that it received the profits *qua* profits, and that such profits are taxable to the estate in the same manner and to the same extent as they would have been taxed to the decedent had he lived and received them.

The partnership agreement here involved provided that in the event of the death of any one of the partners, his estate should have the option of withdrawing his interest within 30 days or, with the consent of the surviving partners, the business could continue. The estate elected to continue the business, and we submit that the venture then organized had the essential characteristics of a partnership. See G. C. M. 7616, IX–1 Cumulative Bulletin 219. The estate "received the same interests, or participated in the losses to the same extent, as said deceased partner would, if living." There was joint liability, and the sharing of profits. No new partnership agreement was drawn, and the relationship therefore rests upon a somewhat informal understanding,[1] but enough appears, we think, to support the conclusion that the estate elected to leave in the business what it was entitled to withdraw, to put it at the risk of the venture and to share in the profits or losses in the same capacity as the surviving partners. In this view there is nothing to distinguish the share of the profits of the business paid to the estate from the same share of the profits paid to the decedent while he lived. It is not questioned that the profits of a partnership are taxable to the partners, but petitioner contends that the character

[1] The written partnership agreement in the record covered only the calendar year 1918, and the business was thereafter continued from year to year by mutual consent without any further agreement. (R. 84.)

of the profits has been changed because the estate had a right to receive them, which was a capital asset, and hence there is no element of income involved until the value of the right is exceeded by the payments.

It is the position of the petitioner that this change in the character of the profits is due to the fact that the surviving partners purchased an asset of the estate, namely, the interest of the deceased partner. The court below, however, construed the partnership agreement differently. In its view the agreement provided only for a method of continuing the business by which the estate of a deceased partner would receive the share of the profits that the decedent would have received, if living, and that the estate, if it elected not to withdraw the decedent's interest immediately, was to give up no rights with respect to the property of the deceased in the business at the date of death (R. 88). The pertinent language of the agreement is quoted in the Statement hereinabove on page 3.

The partnership was engaged in the ship brokerage business and it appears that no capital was required and that none was invested by the partners. Whether the decedent's interest was withdrawn within thirty days of his death or at the end of the current year, it appears that the agreement contemplated that it should consist of a share in the accumulated profits on the agreed date, and that the partners had agreed among themselves that any

good will, interest in unexpired contracts or other intangibles, should belong exclusively to the so-called partnership entity, and that no partner should have any individual interest therein.

Accordingly, when the estate in this case elected not to withdraw the deceased partner's interest, it retained all property rights of the decedent. It retained what it would have lost by withdrawing, and it sold nothing to the survivors. Nor did the estate contract with the surviving partners that the only property it should have was a right to share in the profits. The decedent had already arranged that. The estate accepted the situation, as it necessarily resulted from the partnership agreement, and agreed to take the chance that the accounting at the end of the year would prove more profitable than an accounting within thirty days. We submit that the view of the court below is correct; that the estate had nothing to sell to the survivors, and that it sold nothing to them.

The petitioner ignores the fact that the decedent while he lived, and the surviving partners after he died, all had rights to receive the profits. The estate's right to receive the profits was of the same character.

The decedent had no property right in the partnership profits to be earned after his death. The right here involved never arose until the death of the decedent. It came into existence only when the estate elected to become associated with the surviving partners in the conduct of the business.

Upon the decedent's death the estate had a right to an accounting of the decedent's then existing share of the partnership profits. For reasons satisfactory to the estate, it decided to occupy the position of proprietor in the business, with the accompanying rights and liabilities. This Court has held that such an election is not to be treated as a sale, and that the proceeds may be taxed as income without reduction for the value of the right surrendered. *Helvering* v. *Butterworth*, 290 U. S. 365.

There was no debtor-creditor relationship here between the estate and the surviving partners. They were all associated together in a common enterprise, and the rights of the estate were no different from the rights of the surviving partners. Each was entitled to an accounting for a share of the profits. If the operation of the business had resulted in a loss, the estate would have shared therein, at least to the amount of earnings accrued to the deceased partner at the date of his death. *Burwell* v. *Mandeville's Executor*, 2 How. 560. The surviving partners as individuals were under no obligation whatever to the decedent's estate. As co-proprietors they were under the same obligation to the estate that they were to each other. Hence, the right to share in the profits of the business which belonged to the estate was no different from the right of the surviving partners and no different from the right of the decedent before he died. As one of the proprietors, the estate was entitled to a

share in the earnings. It sold nothing for which it was being paid, and if it made an investment in the business, it was limited to the $24,124.20 which had accrued at the date of the decedent's death; that was the value of the decedent's interest in the business. The estate received from the business $24,124.20 which has not been taxed, thus satisfying the rule applied in *Burnet* v. *Logan,* 283 U. S. 404, that only the excess over the capital value of property received from a decedent is taxable income. In addition, the estate received $200,117.09 as a portion of the profits. This latter amount has been taxed, and we submit, rightly so, as profits from a business received by one entitled to them in the capacity of an owner. As the court said in *United States* v. *Wood,* 8 F. Supp. 939, 940 (E. D. Pa.):

> Treating the decedent and his estate as distinct entities the thought can be followed that the share of profits paid by the firm to the estate was income to the estate from its investment in the partnership * * *

Where one partner dies having an investment in the business which he was entitled to withdraw, the right to withdraw it passes to his estate. Where, instead of withdrawing the deceased partner's interest, the estate leaves it in the business and the surviving partners acquire it by payments made to the estate, the transaction takes the form of a sale. In such a case the surviving partners individually acquire the deceased partner's interest. Any pay-

ments made to the estate out of partnership profits are for and on behalf of the individual partners. Accordingly, in such a case the surviving partners are taxable upon all of the partnership profits, and the estate is not. That was the situation in *Hill* v. *Commissioner,* 38 F. (2d) 165 (C. C. A. 1st), certiorari denied, 281 U. S. 761, and *Pope* v. *Commissioner,* 39 F. (2d) 420 (C. C. A. 1st).

But in this case the surviving partners have not purchased any partnership assets which belonged to the decedent. He had made no investment in the business and owned no tangible property in connection therewith (R. 84). Accordingly, the share of the partnership profits which was paid to the decedent's estate was not a consideration paid by the individual partners and was not paid to the estate for or on behalf of the surviving partners. Hence, the surviving partners would not be taxed upon all of the partnership profits, but only upon their distributive share and unless the decedent's estate is required to report as income the partnership profits distributed to it as such, that portion of the partnership profits will go untaxed.

When the decedent died he had an interest in the partnership. Notwithstanding the partnership agreement, the value of that interest for the purpose of the Federal estate tax was the value at the date of his death. The parties could not increase it by income subsequently earned and thus

build up a larger capital. What was earned subsequently by the business was not any part of the value of the decedent's interest at the date of his death. In this case the value at the date of death has been found by the Court of Claims as $24,124.20.[2] Though the parties agreed that what was earned later in the year should serve to augment the amount to be paid to the estate, we submit that the value of the partnership interest at the date of the decedent's death should not thereby be varied. The value of the decedent's interest was a constant, irrespective of any arrangement made between the surviving partners and the estate. *Ithaca Trust Co.* v. *United States*, 279 U. S. 151.

In *United States* v. *Carter*, 19 F. (2d) 121 (C. C. A. 5th)[3], it is not entirely clear whether the increase over the estimated value at the date of decedent's death was due solely to the correction of an erroneous estimate [4], or to the fact that the estate was entitled to a portion of the profits earned by the partnership subsequent to the death of the de-

[2] The court found that the decedent's share of the partnership profits at the date of his death was $24,124.20, and that he had no other tangible property in the business. (R. 84.) The value of the accumulated profits therefore represented the full value of the decedent's interest. And the petitioner so believed when a return for the estate tax was filed. (R. 85.)

[3] The decision was announced in 1927 but appears never to have been cited since.

[4] The fact that the tate proposed to file an amended return accounting for the increase would indicate that this was so.

cedent. If the case holds that partnership profits *paid as such* to the estate are not income, we submit that it is erroneous.

II

THE AMOUNT OF PARTNERSHIP PROFITS TAXABLE AS INCOME IS NOT LIMITED TO THE EXCESS OVER THE AMOUNT INCLUDED IN THE ESTATE IN COMPUTING THE ESTATE TAX

Even if it be assumed that the right to share in the future profits of the partnership was a property right of the decedent and was properly included in his gross estate for the purpose of computing the estate tax, we submit that the income tax was properly levied upon the receipt of partnership profits by the estate.

The estate tax is levied upon the transfer of the decedent's property at death and includes all property to the extent of the interest therein of the decedent at the time of his death. The income tax, of course, is levied upon the receipt of income and partnership profits are expressly included within the definition as gains or profits derived from the transaction of any business carried on for gain or profit. Section 213 (a), Revenue Act of 1918. We think it follows that the transfer of the right to receive income may be taxed under the estate tax and that the income upon receipt thereafter may be taxed as income.

The property which was taxed as a part of the estate was the deceased partner's interest in the

business, including the right of his estate to share in the future profits. The income tax here involved was levied upon the receipt of the fruits of that right. The two taxes are not only imposed under different principles but are levied in respect of different property. There is, therefore, no double taxation of the same property such as this Court avoided in *United States* v. *Supplee-Biddle Co.*, 265 U. S. 189, or as was discussed in *Nichols* v. *United States*, 64 C. Cls. 241, certiorari denied, 277 U. S. 584.

The principle for which we contend was applied by this Court in *Irwin* v. *Gavit*, 268 U. S. 161. There it was held that the income from a testamentary trust was taxable in the hands of the beneficiary and that the money taxed constituted the fruits of a legacy, and not the legacy itself. The decision establishes that exempt bequests consist of the right to receive income but that the income as it is received is taxable. So in this case the estate was not charged with income on account of the receipt of the right, but only when the estate received the partnership profits. It follows that the inclusion in the gross estate of the value of the right to receive the income does not affect the imposition of an income tax when the income is actually received.

That was the precise point decided in *Waud* v. *United States*, 71 C. Cls. 567. That case involved the income tax imposed upon an estate which received income from a trust fund, it appearing that

the value of the right to receive the income to the end of the term was valued by the Commissioner of Internal Revenue and included in the decedent's gross estate. Upon the authority of *Irwin* v. *Gavit, supra,* the Court of Claims held that the income from the trust fund was taxable when received by the estate.

The case at bar presents a situation substantially similar to that in the *Waud case.* The right to receive future income has been taxed as a part of the gross estate and the partnership profits have been taxed as income when received. Here, as in *Irwin* v. *Gavit* and *Waud* v. *United States,* the right was to receive income as such. In each case the receipt was contingent upon the production of income, and there is no immunity of income properly so called because of a severance between it and the principal fund. What has been taxed here is neither a bequest nor a capital receipt.

The petitioner's attempted distinction that in *Irwin* v. *Gavit* and *Waud* v. *United States* there were principal funds that remained intact after the payment of the income, is, we submit, not substantial, for in neither case did the recipient of the income either own or have any interest in the corpus or principal fund. The capital interest owned by the taxpayer in each case, as in the case at bar, was the right to receive the income—a right which, as in the case at bar, lost its value with the passage of time.

The distinction which makes inapplicable the decision in *Burnet* v. *Whitehouse,* 283 U. S. 148, is plain. There a definite sum was bequeathed each year in the form of an annuity, and it "did not depend upon income but was a charge upon the whole estate during the life of the legatee to be satisfied like any ordinary bequest." (P. 151.) This Court held that the annuity, when received each year, was exempt from income tax as a bequest. The amounts receivable by the legatee in the *Whitehouse case* were not income as ordinarily defined and within the reach of the statute, but rather represented a direct bequest of capital assets payable at intervals. Here, we submit, the amount received by the estate was clearly within the common definition of income.

The petitioner cites the decision of this Court in *Burnet* v. *Logan,* 283 U. S. 404, as controlling authority. There a legatee received a contract right to share in payments that would be made as and when ore was extracted from a mine. Aligning the case with *Burnet* v. *Whitehouse, supra,* rather than with *Irwin* v. *Gavit,* this Court held that payments received, which had not reached in amount the value placed on the contract right as of the time of the testatrix's death, were not taxable income to the legatee. We submit, however, that a number of circumstances remove the effect of the analogy to *Burnet* v. *Logan, supra.* The amounts paid under the contract in that case were promised to the de-

cedent as part of the price of stock purchased from her. (P. 410.) The payments represented a recoupment of capital investment, and the Court so held in the first part of the decision dealing with gain alleged to have been realized from such a sale. The right to periodic returns of capital assets the decedent left to her daughter. The promisor was still fulfilling the obligation to complete a purchase price when payments were made to the legatee. This Court considered the payments to be capital assets in the daughter's hands and applied the rule of *Burnet* v. *Whitehouse, supra.* There are no facts requiring a similar conclusion here. As shown earlier in the brief, the payments made to the estate by the surviving partners did not represent a purchase price. The decedent here had made no capital investment. The share of the partnership profits which his estate received would have been income to him if he had lived. In *Burnet* v. *Logan, supra,* however, the amounts received by the legatee would not have been taxable income to the decedent had she lived to receive them.

The petitioner's contentions that income could be realized only to the extent of amounts received in excess of the amount included in the gross estate, and that the amount here taxed was exempt as a bequest, do not differ in substance from the argument that the amount here taxed was corpus because it had been included in the gross estate.

We submit that the whole amount received by the estate was income and taxable under the rule

of *Irwin* v. *Gavit, supra.* Its character as income was not lost, in whole or in part, because it was used to measure the value of a right included in the decedent's gross estate.

CONCLUSION

The partnership profits were received by the estate as a proprietor in the business and were, therefore, taxable as income. Inclusion of the value of the right to receive the profits in the gross estate of the decedent did not affect their taxability as income to the estate. We submit that the decision below is correct and should be affirmed.

Respectfully submitted.

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APRIL 1935.

APPENDIX

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1065, 1070, 1071:

SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transactions of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

(b) Does not include the following items, which shall be exempt from taxation under this title:

* * * * *

(3) The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income);

* * * * *

SEC. 218. (a) That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner his dis-

tributive share, whether distributed or not, of the net income of the partnership for the taxable year.

* * * * *

SEC. 219. (a) That the tax imposed by sections 210 and 211 shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income received by estates of deceased persons during the period of administration or settlement of the estate;

* * * * *

(b) The fiduciary shall be responsible for making the return of the income for the estate or trust for which he acts. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, * * *.

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